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FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of
Federal State Joint Board on Universal Service

CC Docket No. 96-45
(Report to Congress)

COMMENTS BY THE PUBLIC SERVICE COMMISSION
ON UNIVERSAL SERVICE

The Public Service Commission of Wisconsin (PSCW) respectfully submits the following comments on item number five in your notice, the relative portions of the universal service funding which should be paid by the interstate and intrastate jurisdictions. In its May 8, 1997 order on Universal Service, the Federal Communications Commission (FCC) tentatively set this portion at 25 percent interstate.

The PSCW wishes to point out that the 25 percent number is not magical. It is a historical legacy of a series of political compromises in a matter only tangentially related to universal service. The 25 percent figure was the most recent compromise between the states and FCC on the relative allocation of nontraffic sensitive (NTS) costs. Nontraffic sensitive costs are those that do not vary with usage, or with demand. As a result, economists cannot state that any one allocation of these costs between intrastate and interstate usage is correct.

When long distance service first originated, no NTS costs were allocated to the service, under the "board-to-board" costing methodology. Over time, however, the costs of long distance service fell, as more efficient transport, such as fiber optics, were introduced. At the same time, the cost of local service increased, as multi-party service was eliminated and switches supporting more elaborate services were introduced. This relative cheapening of interstate service caused

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considerable pressure to rebalance interstate and intrastate rates by moving some costs, especially NTS costs, into the federal jurisdiction.

From the 1940s to the mid 1970s, a number of federal-state joint boards recommended increasingly higher allocations of NTS costs to the interstate jurisdiction. These plans were sometimes named for the cities in which the federal-state joint boards met (e.g. Charleston, Denver, Ozark, etc.), or by the name of the factor (SPF, FCC Plan, SLU). In each case, the allocation was a reasonable compromise, but was not based on economic theory.

By the mid-1970s, the relative political pressures were more balanced, while interstate demand was rising rapidly. As a result, the rather peculiar interstate allocation factor then used, SPF, was rising very rapidly. In 1981, the FCC froze the factor at the then-current levels. The resulting allocator, "frozen 1981 SPF" is the clearest indication that the NTS allocation used was the result of a political process, not of economic theory or analysis. The SPF factor had almost no theoretic basis: it's main appeal was that it transferred the agreed-upon amount of money from the state to federal jurisdictions in the year it was adopted. The frozen SPF factor had even less rationale: it merely stopped the ever increasing portion of costs then moving to the interstate jurisdiction.

The FCC then transitioned to a flat 25 percent NTS allocator. Once again, the major reason for the 25 percent figure was political. Neither the interstate toll providers, nor the state on behalf of intrastate and local customers, wanted to pay the NTS costs. Both sides fought hard to move those costs onto the other side. The resulting compromise was to move from frozen 1981 SPF to 25 percent over seven years. One major advantage to 25 percent was that it was close to, and slightly below, the average interstate NTS allocation under frozen SPF.

Some parties will argue that the appropriate percentage is less than 25 percent, because interstate usage constitutes less than 25 percent of all usage. The PSCW disputes that the correct interstate percentage is that low (see below.) Moreover, using the actual interstate portion of minutes to split state and interstate responsibility for universal service would not necessarily be correct, since much of the costs in high cost areas related to outside plant, are not traffic sensitive and have no relation to usage. Further, by using relative minutes of use, the split would not take into account the economies of scale of other services, such private line and advanced custom calling features, that are not reflected in minute of use numbers.

The current percentage of traffic designated as intrastate under FCC rules is inaccurate. Currently, traffic traveling over local facilities to an interexchange carrier's network, and from there to an out-of-state destination, is designated as interstate. A similar call, if sent to an enhanced service provider (ESP) – for example an Internet service provider (ISP) – is by default counted as local traffic or intrastate toll. While there are good reasons for not applying access charges to Internet and ESP traffic, including such traffic in intrastate counts skews the relative percentages. The extent of this distortion is not clear, since such traffic is not tracked by either states or the FCC. However, given the usual estimates of amount of Internet usage, the number of minutes involved is likely to be significant already, and is growing rapidly.

Furthermore, the FCC has stated that one reason for giving states the bulk of the burden of the universal service fund assessment is that the states retain implicit subsidies in intrastate rates. For example, business and residential services continue to be charged different amounts for similar services. However, the PSCW would point out that the FCC is in the same position relative to access charges for ISPs and ESPs: customers are being charged different amounts for similar services. A call transported over a local exchange carrier's network to an interexchange

carrier's network is charged access rates. The same call carried in the same manner to an ISP's or ESP's network is not. The PSCW recognizes the FCC is moving to eliminate this subsidy, but has not yet completed the task. Likewise, the PSCW has been working to eliminate implicit subsidies in Wisconsin for several years, but has not completed that task, either. The PSCW questions whether, given the fact that both the FCC and the states still have implicit subsidies, whether allocating an additional burden to the states is reasonable. Furthermore, in some respects, Wisconsin is ahead of most other states in eliminating such implicit subsidies. By making a blanket assertion that states should bear a larger portion of the costs, the FCC is penalizing states like Wisconsin because other states have not kept pace.

The FCC could consider splitting the responsibility for universal service recovery on the basis of relative state and interstate revenue. However, the impact of such a split would be identical to that of having the FCC pay 100 percent of the costs, but assessing both interstate and intrastate revenues.

The FCC could adopt other splits. For example, regulators define three basic types of services: interstate toll, intrastate toll, and local. This could "justify" a one-third, two-third split. Likewise, since there are two jurisdictions, the FCC could defend a 50-50 split, with each jurisdiction paying half.

As the history of NTS allocation shows, the FCC could adopt, and find a method of justifying, any number between 1 and 100 percent. The FCC should base its choice on the impact of the number chosen.

The FCC should consider the effect on the states of having a high intrastate allocation. The PSCW has not completed its review of cost models, and does not have accurate estimates of what the intrastate portion could be, but it is clear that it will be substantial. Using earlier

versions of the national cost models and the tentative benchmark amount from the FCC's May 8, 1997 universal service order, staff has estimated that the high cost assistance program alone would require an assessment of 5 to 15 percent of intrastate revenues. For some other states, the percentage would be much higher. Estimates for South Dakota, for example, have ranged above 50 percent. In other states, it would be significantly lower.

Wisconsin has made significant strides to attract and retain high technology jobs. Wisconsin currently ranks first in number of people in high technology jobs per capita, nearly double the second highest state, Massachusetts. However, if Wisconsin will be required to impose a 15 percent universal service assessment on all telecommunications services, while other states charge significantly less, then firms may move to states with lower intrastate universal service assessments. Such high-tech, information and knowledge-based firms rely heavily on telecommunications services.

The basic concept of universal service is that, for those areas or customers for which the market would not offer service at affordable prices, the universal service program will step in with support. To provide this support, other customers will be assessed a "tax" or assessment to fund universal service. One important goal with any such assessment is that it be broad and uniform enough that it does not distort the market or drive firms to make choices they would otherwise not have made. Further, high cost areas should not be required to subsidize themselves. Such a plan will not work.

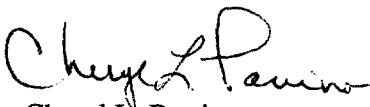
In at least some cases, entire states can be considered high cost areas. Requiring such states to pay the majority of their subsidies themselves is self-defeating. In other cases, having the states pay a majority of the universal service subsidy will create incentives for firms to leave those states. This should also be avoided.

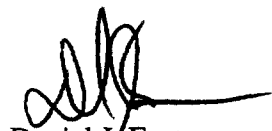
Having a wide disparity between the interstate and intrastate assessments can also affect the services purchased. In many cases, such as special access, interstate and intrastate services are substitutable. Customers have had to declare whether the service is interstate or intrastate in nature. When the price has varied, the percentage of services declared to be in the lower cost jurisdiction has risen markedly. In other cases, networks have been designed to be interstate in nature solely for price advantage, a technique called the "rusty pedestal." If the universal service assessment were to be significantly higher in either jurisdiction, similar uneconomic actions will occur.


In short, the FCC should place the maximum possible percentage in the interstate portion given political and rate impact implications. This will ensure a uniform assessment and will minimize the impact on individual states and on economic development. However, the FCC should also try to keep the extent of state to state transfers to a minimum. The NARUC has been working on alternative proposal to meet these varied objectives, and we believe that the FCC should consider carefully the NARUC proposal.

Dated at Madison, Wisconsin, January 23, 1998

Respectfully submitted:


Cheryl L. Parrino
Chairman


Daniel J. Eastman
Commissioner


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